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Before the
FEDERAL COMMUNICATIONS COMMISSION
Common Carrier Bureau
1919 M Street, N.W.
Washington, D.C. 20554

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In the Matter of Request by ALTS for Clarification of the Commission's Rules Regarding Reciprocal Compensation for Information Service Provider Traffic	DA 97-1399 CCB/CPD 97-30

REPLY COMMENTS OF ADELPHIA COMMUNICATIONS CORPORATION, BENCHMARK COMMUNICATIONS, INC., CENTURY COMMUNICATIONS CORP., DANIELS CABLEVISION, INC., FREDERICK CABLEVISION, INC., GREATER MEDIA, INC., INTERMEDIA PARTNERS, JAMES CABLE PARTNERS, L.P., JONES INTERCABLE, INC., MARCUS CABLE COMPANY, L.P., RIFKIN AND ASSOCIATES, INC., STARSTREAM COMMUNICATIONS, INC., AND WINDKEEPER COMMUNICATIONS, INC.

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I. INTRODUCTION AND SUMMARY.

The Joint Commenters[1] hereby reply to other parties' comments in this matter.

The comments reveal a universal loathing for the claim by incumbent local exchange carriers (ILECs) that calls to Internet Service Providers (ISPs) are not subject to reciprocal compensation under Sections 251(b)(5) and 252(d)(2) of the Communications Act. It is clear that no one other than the ILECs gives any credence

[1] The Joint Commenters are (in alphabetical order) Adelphia Communications Corporation, Benchmark Communications, Inc., Century Communications Corp., Daniels Cablevision, Inc., Frederick Cablevision, Inc., Greater Media, Inc., Intermedia Partners, James Cable Partners, L.P., Jones Intercable, Inc., Marcus Cable Company, L.P., Rifkin and Associates, Inc., Starstream Communications, Inc., and Windkeeper Communications, Inc. Their previously-filed comments in this matter are cited as the "Joint Comments."

to the idea that calls to ISPs should be treated as anything other than local calls. Indeed, as Bell Atlantic's frequently-cited comparably-efficient interconnection plan reveals, until quite recently the ILECs gave no credence to the idea either.[2]

In support of their new theory, the ILECs offer little more than the confused "interstate traffic can't be local" argument discussed in the initial comments of the Joint Commenters and dozens of others. Rather than simply repeat points already made, these Reply Comments focus on the following issues.

First, some of the ILECs' confusion surrounding the status of calls to the Internet may be alleviated by reviewing certain key definitions in the Communications Act. In particular, the ILECs muddle two very different statutory dichotomies. The statutory distinction between "telephone exchange service" and "telephone toll service" addresses whether a call is local. On the other hand, the distinction between "interstate communication" and "intrastate communication" addresses which regulator has jurisdiction. A call is local if it is provided by means of "telephone exchange service." A communication is "interstate" if it travels from one state to another. While most interstate traffic is carried on toll calls, the "local/toll" dichotomy and the "interstate/intrastate" dichotomy operate separately and effectuate separate statutory purposes. Under this statutory structure, certain classes of calls — including calls to the Internet — are both local and interstate.

Second, precisely because calls to the Internet are jurisdictionally interstate, the Eighth Circuit's recent ruling in the appeal of the Commission's *Local Competition Order* neither divests the Bureau of jurisdiction to decide the issue before it nor, ultimately, affects the correct analysis of that issue. Taken on its own terms, the

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[2] *See, e.g.*, Comments of WorldCom, Inc. at 10 n.22, *citing Offer of Comparably Efficient Interconnection to Providers of Enhanced Internet Access Services*, Amendment to Bell Atlantic Plan to Expand Services Following Merger with NYNEX, CCB Pol. 96-09 (rec'd May 5, 1997) at 3.

court's order simply re-affirms the traditional jurisdictional split that allows the Commission to regulate interstate, but not intrastate, communications. Indeed, the court was careful to refer to the "local, intrastate" character of the interconnection services whose prices it barred the Commission from regulating. The issue at hand, by contrast, relates to local calls that are jurisdictionally ***interstate.*** These calls, therefore, are similar to interstate, but local, CMRS calls In this parallel situation, the court specifically affirmed the Commission's right to determine that calls within an MTA are "local" for purposes of reciprocal compensation

Finally, Ameritech argues that it would be unfair to the ILECs to require compensation for calls to ISPs who buy their local exchange service from competitive local exchange carriers (CLECs). According to Ameritech, this is because the CLECs are misusing the terminating compensation system by negotiating for rates that turn the receipt of calls into a "cash cow," then using the cash to fund low rates for ISPs. This analysis is flawed for three main reasons:

- Many of the costs of running a telecommunications network are non-cash expenses such as depreciation. This means that an economically "correct" cost-based payment for terminating calls will almost certainly exceed the short-run cash outlays required to perform that function. Such a payment, therefore, will provide a source of short-term cash. CLECs will logically focus their immediate business efforts on activities that will generate cash. Initially targeting customers with high incoming call levels is one way to execute this totally legitimate business strategy.

- In addition, telecommunications networks exhibit economies of scale. As usage increases, therefore, a CLEC's unit costs will decline. A cost-based terminating compensation rate that reflects long-run costs will almost certainly be ***too low*** to cover CLECs' call termination costs until usage increases above start-up levels. Customers with high incoming calling patterns will help drive usage to levels at which the terminating compensation payment is actually compensatory. This need to obtain economies of scale as rapidly as possible creates a strong incentive for CLECs to target ISPs and other customers with high incoming usage

- Any form of terminating compensation other than bill-and-keep will create an incentive for all competing carriers to secure the business of end users that receive more calls than they make. Ameritech and the other ILECs were free to avoid this problem by negotiating for bill-and-keep arrangements. By opposing such arrangements, the ILECs were implicitly betting that the CLECs would not be able to secure the business of such customer groups. They appear to have lost their bet. In light of the focus of the 1996 Act on negotiated interconnection agreements, it would be totally inappropriate for the Bureau to issue a ruling that relieved the ILECs of the consequences of their negotiating strategy.

These Reply Comments are organized as follows. Section II addresses the status of calls to the Internet in light of the specific applicable definitions and jurisdictional provisions in Sections 2 and 3 of the Communications Act. Section III shows that nothing in the Eighth Circuit's recent ruling suggests that the Commission lacks the legal authority to declare calls to the Internet to be "local" for purposes of terminating compensation. Finally, Section IV addresses the policy arguments raised by Ameritech and shows that nothing in the pro-competitive policies of the 1996 Act, or in the specific policies underlying terminating compensation, even remotely support the ILECs' position that calls to the Internet should be exempted from such compensation.

II. KEY DEFINITIONS IN THE COMMUNICATIONS ACT SHOW THAT CALLS TO THE INTERNET ARE BOTH "LOCAL" AND "INTERSTATE."

The ILECs assume that a call that is "local," and, therefore, subject to reciprocal compensation, cannot also be "interstate."[3] From this premise they reason that, since traffic end users send to and receive from the Internet is jurisdictionally interstate, calls to the Internet cannot be local calls.

This claim is baseless. As the Joint Comments explained, there is nothing inconsistent about the same call being both "local" and "interstate."[4] The ILECs' comments, however, reveal profound confusion regarding this issue. As discussed below, that confusion can be resolved — and the accuracy of the Joint Commenters' analysis confirmed — by reference to certain key definitions in the Communications Act.

The first, basic definition is "interstate communication." An "interstate communication" is any "communication ... from any State, Territory, or possession of the United States ... or the District of Columbia," to any other such jurisdiction.[5]

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[3] Comments of the United States Telephone Association and Member Companies ("USTA Comments") at 3-4; Ameritech Comments at 6-10; Comments of the Southern New England Telephone Company ("SNET Comments") at 3-6.

[4] *See* Joint Comments, Section III.

[5] 47 U.S.C. §153(22). There are two main exceptions to this rule. They are: (a) communications which originate and terminate in the same state, but which are routed through another state, and (b) communications which originate and terminate in different states but which are part of local exchange service. In the first case, if the end-to-end communication is regulated by the state in which it originates and terminates, it is excluded from the definition of "interstate." *See* 47 U.S.C. §153(22). In the second case, if the end-to-end service in a metropolitan is regulated by one or more states, then, under 47 U.S.C. § 221(b), the Commission may not regulate it, despite the fact that "a portion of such exchange service constitutes interstate or foreign communication." The restriction on the Commission's jurisdiction in Section 221(b) is limited to the problem of multi-state local calling areas. *See* *Puerto Rico Telephone Company v. FCC*, 553 F.2d 694, 698-99 (1st Cir. 1977).

Interstate communications are subject to the jurisdiction of the Commission, as opposed to individual states, which regulate intrastate communications.[6] This interstate/intrastate dichotomy establishes which regulator has ultimate authority with regard to a particular communication. That is, the statutory "opposite" of an interstate communication is not a local communication. It is an intrastate communication.

A completely different statutory dichotomy applies when the question is whether a particular telephone call is local or toll Whether a call is local is determined by reference to Section 3(47) of the Act. Section 3(47) defines "telephone exchange service" as:

> (A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service.

Under this definition, the statutory "opposite" of a local call is not an interstate call, but, instead, a toll call.[7] In fact, "telephone toll service" is defined as "telephone

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[6] *See* 47 U.S.C. § 152(a) (giving the Commission jurisdiction over interstate communication); 47 U.S.C. § 152(b) (depriving Commission of jurisdiction with respect to "intrastate communication service").

[7] Although this definition does not use the term "local" service, a related definition simply states that a "local exchange carrier" is a provider of either "telephone exchange service" or "exchange access." *See* 47 U.S.C. §153(26). As a result, "telephone exchange service is essentially a local service." In the Matter of Implementation of Infrastructure Sharing Provisions in the Telecommunications Act of 1996, FCC 97-36 (released February 7, 1997) at ¶ 84.

service between stations in different exchange areas for which there is made a separate charge not included in contracts with subscribers for exchange service."[8]

It is certainly true that normally a local call (*i.e.*, a particular use of "telephone exchange service") will almost always be an intrastate communication. But calls to the Internet are not the norm; to the contrary, as Ameritech and USTA observe, calls to the Internet are *sui generis*.[9] For that very reason, it is critical to avoid relying on the typical assumptions that apply to well-established, well-understood situations without examining whether those assumptions actually apply.

One such assumption is that a call that meets the definition of "telephone exchange service" cannot be jurisdictionally interstate. While it is true as a practical matter that most "local exchange" calls are also jurisdictionally intrastate, nothing in the relevant definitions supports the conclusion that such local calls ***must be*** intrastate. Indeed, upon examination, such a conclusion makes no more legal sense than saying that a call between San Francisco and Los Angeles must be jurisdictionally interstate, under the terms of Section 3(22), simply because it is not an "exchange service" call under the terms of Section 3(47). The jurisdictional question, in short, is legally distinct from whether a call is local or not.

Communications between an individual end user and the Internet are clearly jurisdictionally "interstate" because signals are sent and received between an end user in one state and (typically) multiple Internet host computers located in other states. At the same time, calls to the Internet are plainly "local calls" because they are

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[8] 47 U.S.C. § 153(48).

[9] Ameritech Comments at 11; USTA Comments at 8.

established by means of traditional circuit-switched telephone exchange service that connects two local telephone numbers.[10]

For this reason, Ameritech is simply wrong when it states that, if the Commission classifies calls to the Internet as "local," Internet traffic "would remain forever ... outside the jurisdiction of the Commission."[11] Similarly, USTA and Cincinnati Bell are talking legal nonsense when they refer to a possible change in "the jurisdictional nature of ISP traffic" from "interstate" to "local."[12] Jurisdictionally, traffic is either interstate or intrastate, determined by applying the definition in Section 3(22) of the Act. There is no such thing as "jurisdictionally local" traffic. As a result, treating calls to the Internet as "local" has no effect on the "jurisdictional nature" of the calls.[13]

Moreover, treating calls to the Internet as local certainly does not result in the Commission somehow ceding legal jurisdiction over them to the states. To the contrary, in connection with the treatment of enhanced services, the Commission has

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[10] *See* Joint Comments, Section III.C. It is significant that calls to the Internet cannot properly be classified as a form of "exchange access" service. That service is defined as "the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services." 47 U.S.C. §3(16). *See infra.*

[11] Ameritech Comments at 15.

[12] USTA Comments at 3; Comments of Cincinnati Bell Telephone Company at 2.

[13] Ameritech cites the recent OPP paper *Digital Tornado: The Internet and Telecommunications Policy* for the proposition that "[t]he Internet is simultaneously ***local,*** national, and global." Ameritech Comments at 12 (citations omitted, emphasis added). Yet Ameritech steadfastly refuses to acknowledge what the "local" aspect of the Internet might be. For the reasons described above and in the Joint Comments, the Internet is, in part, "local" because the Internet, by means of ISP points of presence and otherwise, has a presence in a large number of local calling areas around the country.

specifically held that allowing jurisdictionally interstate services to be provided under the terms of state-level tariffs ***does not*** constitute a surrender of jurisdiction.[14]

The statutory definitions discussed above also support the distinction between circuit-switched telephone "calls" — to which terminating compensation applies under Section 252(d)(2) — and other types of "communications," such as packet-switched data transmissions on the Internet. The definition of "telephone exchange service" appeals directly to the general understanding of local calling — "intercommunicating service of the character ordinarily furnished by a single exchange."[15] In contrast, the notion of an "interstate communication," which is used to

[14] *See, e.g.*, In the Matter of Petition for Emergency Relief and Declaratory Ruling Filed by the BellSouth Corporation, *Memorandum Opinion and Order*, 7 FCC Rcd 5 (1992) ("*Voice Mail Order*") at ¶12 ("The Commission also has made it clear that it has not ceded jurisdiction over call forwarding when used in interstate communications even if that service is locally tariffed."), *citing* In the Matter of Filing and Review of Open Network Architecture Plans, *Memorandum Opinion and Order*, 4 FCC Rcd 1 (1988) at ¶ 277 & n.628 ("[W]e theoretically could require dual federal/state tariffing or possibly even exclusive federal tariffing ... for such a service.") Unlike USTA and Cincinnati Bell, SNET at least implicitly recognizes that the jurisdiction of tariffing does not determine which regulator has ultimate legal jurisdiction over particular traffic. *See* SNET Comments at 5 ("[T]he fact that ISPs purchase service from incumbent LECs via intrastate tariffs does not prove that such traffic is intrastate in nature.")

[15] Any doubt that "telephone exchange service" refers to telephone calls to lines served with standard telephone numbers is dispelled by Section 271(c)(2)(B)(viii), which requires Bell companies, as part of the "competitive checklist," to provide "white pages directory listings for customers of the other carrier's ***telephone exchange service.***" *See also* Section 222(e) (directing providers of "telephone exchange service" to make lists of their subscribers available for the purpose of publishing directories). Telephone numbers (included in directories) are associated with "telephone exchange service" because that service, at bottom, is the ability to dial a telephone number in a local calling area and establish a clear circuit-switched path to the local loop to which the number is assigned. *See* In the Matter of the Need to Promote Competition and Efficient Use of Spectrum for Radio Common Carrier Services, *Memorandum Opinion and Order*, FCC 86-85, 59 RR 2d 1275 (1986), Appendix B, ¶ 4 (NXX codes and telephone numbers are used "for the efficient operation of the ***public switched network***") (emphasis added). Indeed, "the basic function of the NNX code is to instruct switching machines ***in the local exchange system*** how to route incoming traffic." In the Matter of Referral of Questions from General Communication Incorporated vs. Alascom, Inc. in the United States District Court for the Western District of Washington Request for

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define the Commission's jurisdiction under Section 2(a) and Section 3(22), is much broader. It encompasses the "transmission of writing, signs, signals, pictures, and sounds ***of all kinds*** ... between the points of origin and reception of such transmission."[16]

As a result, while all telephone ***calls*** — local or toll, interstate or intrastate — are "communications," not all "communications" are calls.[17] One of the unusual features of dial-up communications between individual end users and the Internet is that one part of the communication — the link between the end user and the ISP — meets the definition of a "call," while other parts — the data transactions within the Internet — do not. This situation ceases to be merely a statutory oddity in those cases where important consequences flow from whether a "call" is involved. A LEC's entitlement to terminating compensation under Section 252(d)(2) is such a case.

The ILECs' comments on these topics are hopelessly confused. They assume that all communications can be treated as circuit-switched calls; they assume that local "calls" cannot be jurisdictionally interstate; and they assume that the regulatory and jurisdictional analysis applicable to access services — with which they are most familiar — literally apply to individual end users accessing the Internet. All of these assumptions are wrong.

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[15](...continued)
Declaratory Ruling of General Communication Incorporated Regarding Alascom's Misrepresentation and Misapplication of Its WATS Tariffs, *Memorandum Opinion and Order,* 3 FCC Rcd 700 (1988) at ¶ 58 (emphasis added).

[16] 47 U.S.C. §3(51) (defining "communication by wire").

[17] The traditional distinction is between (a) normal telephone calls, *i.e.*, telephone exchange or telephone toll service, and (b) non-switched, dedicated private line connections. *See, e.g.*, In the Matter of Regulatory Policies Concerning Resale and Shared Use of Common Carrier Services and Facilities, *Report and Order*, 60 F.C.C.2d 261 (1976) at ¶ 64 ("[T]o qualify as a private line service, at least one aspect of the service must be a dedicated facility not used or usable for local telephone exchange service.") In this regard, the telecommunications facilities (as opposed to the computers) that make up the Internet itself consist largely of non-switched private lines.

As a result, the three cases they cite in support of their claim that calls to ISPs cannot be "local" — voice mail,[18] Feature Group A and B,[19] and resold WATS/800 services[20] — are simply inapposite. In each of those cases, the communication being established is a circuit-switched call between two points. In that situation, there is no dispute that the jurisdictional nature of the communication is determined by the end points of the call, viewed as a whole.[21] This is because the circuit-switched call and the total "communication" begin and end at the same points. In the case of calls to the Internet, however, the "call" terminates at the ISP's location even though the "communication" continues on to other points. In this situation, the standard rule that

[18] *See* USTA Comments at 5 (n. 13), *citing Voice Mail Order, supra.*

[19] *See* USTA Comments at 9 (n. 27), *citing* In the Matter of Determination of Interstate and Intrastate Usage of Feature Group A and Feature Group B Access Service, *Memorandum Opinion and Order*, 4 FCC Rcd 25 (1989).

[20] *See* USTA Comments at 5 (n.13), *citing* In the Matter of AT&T Communications Revisions to Tariff FCC No. 2 (800 ReadyLine Service), *Memorandum Opinion and Order,* 2 FCC Rcd 78 (1986).

[21] In light of the nature of a circuit-switched connection, it is perfectly logical to treat a chain of linked calls as a single call. Once a clear transmission path has been established from Point A to Point B, and from Point B to Point C, a clear transmission path (barring technical failure) necessarily exists between Points A and C. USTA is therefore correct, ***in the context of a circuit-switched call,*** that "[i]t is the end-to-end configuration of ***the call*** that determines its jurisdictional nature, not any intermediate switching and/or transport." USTA Comments at 5 (emphasis added). Where USTA misses the point is its assumption that circuit-switched "calls" to the Internet actually extend into the Internet itself. *See* Joint Comments, Section III.B. Indeed, it is only USTA's parochial, circuit-switched view of the world that allows it even to imply that the functions performed by ISPs and the Internet amount to "intermediate switching and/or transport" of "calls." SNET also ignores the fundamental difference between circuit-switched and packet-switched technology when it characterizes the ISP's function as simply "convert[ing] the analog signal to a digital signal and aggregat[ing] the traffic onto the Internet." SNET Comments at 2. The Internet is not simply a souped-up digital multiplexer of the sort used in circuit-switched networks to carry multiple telephone calls in digital form at high data rates. To the contrary, during a single "call" to the Internet, an individual end user may access data from a wide variety of different sources in different states, without ever establishing a transmission path to any of them.

a chain of calls is properly viewed as a single, integrated call for jurisdictional purposes simply does not apply.[22]

Moreover, it would be erroneous, from a strict statutory perspective, to lump calls to the Internet into an overall category of "access" service. The Telecommunications Act of 1996 added a formal statutory definition of "exchange access" that limits the proper application of that term considerably: "The term "exchange access" means the offering of access to telephone exchange services or facilities ***for the purpose of the origination or termination of telephone toll services.***"[23] Whatever connecting to the Internet by means of a dial-up connection may be, it is not using "telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services."[24]

For all of these reasons, and for the reasons stated in the Joint Comments, the Bureau should rule that, when an individual end user calls the Internet by means of

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[22] There is, therefore, no basis for Ameritech's claim that "with respect to the Internet at least, the Commission would be on especially flimsy ground if it attempted to treat Internet access and Internet services as separate calls." Ameritech Comments at 13 (emphasis added). When an individual end user establishes a dial-in connection to the Internet, there is undoubtedly only one "call." What Ameritech fails to grasp is that the one "call" ends at the ISP's premises.

[23] 47 U.S.C. §3(16) (emphasis added).

[24] The only possible exception would be Internet telephony, at present a relatively insignificant aspect of Internet usage. For this reason, USTA's reference to the sort of jurisdictional "allocation" applicable to Feature Group A traffic is totally inapposite. *See* USTA Comments at 9. In any event, the Commission was well aware of Internet telephony when it continued its policy of exempting ESPs, including ISPs, from access charges. *See* In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, and End User Common Line Charges, *First Report and Order,* CC Docket Nos. 96-282 *et al.*, FCC 97-158 (released May 16, 1997) ("*Access Charge Order*") at ¶¶ 344-348. To the extent that any calls from individual end users to the Internet can reasonably be classified as "access," therefore, the Commission has already concluded that ISPs should be treated as end users. *See* Joint Comments, Section III.A.

a local ISP's dial-in line, the "call" is subject to terminating compensation because it is provided by means of local telephone exchange service, even though the overall "communication" is interstate in nature and, therefore, subject to the Commission's jurisdiction.

III. THE AUTHORITY OF THE BUREAU TO RULE THAT CALLS TO THE INTERNET ARE SUBJECT TO COMPENSATION IS NOT AFFECTED BY THE EIGHTH CIRCUIT'S RECENT RULING.

Nothing in the Eighth Circuit's recent ruling in the appeal of the Commission's *Local Competition Order*[25] divests the Bureau of jurisdiction to decide the issue before it nor, ultimately, affects the correct analysis of that issue. To the contrary, the Eighth Circuit's order is totally consistent with the Joint Commenters' analysis.

Taken on its own terms, the Eighth Circuit's opinion simply re-affirms the traditional jurisdictional split that allows the Commission to regulate interstate, but not intrastate, communications. Nothing in such a ruling, and nothing in the court's specific order, in any way supports a conclusion (essential to the ILECs' position) that all local communications are also intrastate communications, and that no interstate communications can be local. To the contrary, the court generally used the same precise language to characterize the matters that it was holding to be beyond the Commission's jurisdiction. Over and again, the court described the services over which the Commission did not have jurisdiction, and as to which the Commission could not regulate, as both "local" ***and*** "intrastate."[26]

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[25] *Iowa Utilities Board v. FCC,* No. 96-3321, slip op. (8th Cir. July 18, 1997).

[26] Slip op. at 101 (Section 2(b) "denies the FCC jurisdiction to determine these rates because the rates involve ***local intrastate*** communications service."); *id.* at 102 (certain provisions do not "supply the FCC with the authority to issue regulations governing the pricing of the ***local intrastate*** telecommunication services" that ILECs must provide to competitors); *id.* at 103 (Section 201(b) does not give the Commission "the authority to regulate the rates of ***local intrastate*** phone service"); *id.* at 106 n.16 (court notes that the Commission "acknowledges that the [1996 Act] deals predominantly with ***local intrastate*** markets"); *id.* at 120 (interconnection duties involve "***local intrastate*** telecommunications services."); *id.* at 123 (Sections 251 and 252 "fundamentally involve ***local intrastate*** telecommunications matters"); *id.* at 124 (fulfilling Section 251 and 252 duties "almost exclusively involve ***local intrastate*** telecommunication services.")

The specific matter at issue here — the treatment of calls to the Internet — was obviously not before the court. There is no reason to suspect, however, that the court somehow concluded either that there was no such thing as a "local, interstate" service or that, where such a service existed, the Commission would lack jurisdiction with regard to it. To the contrary, in all likelihood the court was at such pains to emphasize not only the "local" character, but also the "intrastate" character, of the services it was fencing off from the Commission precisely because — after extensive statutory briefing and argument — it was well aware that nothing in the Communications Act forbids the Commission from regulating regarding "local" matters. It is only "intrastate" matters that are beyond the pale in the absence of an express or implied exemption from Section 2(b).

Indeed, the court came down in favor of the Commission's jurisdiction in the only analogous situation that was involved in the appeal. Specifically, the court expressly upheld the Commission's authority to set the scope of "local" calling areas for CMRS providers. The court held that the Commission could determine the local calling areas for CMRS providers because it had jurisdiction over CMRS traffic. In the CMRS case, this jurisdiction arose due to an exemption to Section 2(b). The logic of this ruling is that, for purposes of Section 251(b)(5) and Section 252(d)(2), the regulator with jurisdiction over a particular class of traffic gets to determine the local calling area applicable to local exchange calls that carry that traffic. Here, the peculiar nature of the Internet and dial-up access to it creates a situation in which the Commission has jurisdiction over local calls to the Internet. The Commission, therefore, is the regulator with the authority to declare that such calls are "local" for purposes of reciprocal compensation, just as it can declare that a call from Bangor, Maine to Newport, Rhode Island (both within MTA No. 8) is "local" for those purposes.[27]

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[27] As noted above, the court stated that fulfilling Section 251 and 252 duties "***almost*** exclusively involve local intrastate telecommunication services." *Id.* at 124. The use of the term "almost" constitutes a recognition that exceptions to the general rule exist. The situation

(continued...)

It is also significant for purposes of the matter at hand that the court took pains to state, repeatedly, that it was striking down the Commission's effort to involve itself in the implementation of the ***pricing*** provisions of the 1996 Act.[28] Nothing in the matter at hand involves prices. Instead, all that is needed in this proceeding is a ruling that (a) calls to the Internet are under the Commission's jurisdiction; (b) they (like LEC/CMRS calls) are subject to reciprocal compensation obligations; and (c) that ILECs may not discriminate between these calls and other calls within a given local calling area. Such a ruling would assure fair treatment of calls to the Internet, but would not implicate pricing issues at all.[29]

At bottom, therefore, nothing in the Eighth Circuit's opinion purports to divest the Commission of any of its regulatory authority over jurisdictionally interstate communications, and specifically affirmed the Commission's right to declare certain interstate, local calls to be subject to reciprocal compensation. Calls to the Internet represent another unusual case — similar to interstate, intraMTA CMRS calls — of local calls (*i.e.*, in statutory terms, "telephone exchange service") that are also jurisdictionally interstate. Consistent with the court's treatment of CMRS calls, and consistent with the general split of jurisdictional authority mandated by Sections 2(a) and 2(b) of the Act and affirmed by the court, this Commission has the authority to declare that calls to the

[27](...continued)
of "interstate but local" intraMTA CMRS traffic is one such exception. "Interstate but local" calls to the Internet is another.

[28] *See* excepted quotations listed in note 26, *supra*.

[29] In this regard, the court held that the Commission's authority over access charges did not allow it to interfere in questions regarding the pricing of interconnection between LECs under Sections 251 and 252. Slip Opinion at 112 n.20. As noted above, however, except in highly unusual cases, calls to the Internet do not meet the statutory definition of "exchange access," so this holding does not apply here. Again, the proper analogy is to local calls that are under the Commission's regulatory jurisdiction, such as intraMTA CMRS calls.

Internet within an appropriately defined local calling area are, indeed, "local" calls subject to terminating compensation under Sections 251(b)(5) and 252(d)(2) of the Act.[30]

[30] The Eighth Circuit's ruling does affect one aspect of this proceeding. Although not directly related to "pricing," the Eighth Circuit nonetheless vacated Section 51.701 of the Commission's rules, except as that provision (and certain others) relate to interconnection between ILECs and Commercial Mobile Radio Services providers. If Section 51.701, in legal effect, no long exists, then little purpose would be served by clarifying it to indicate that calls to the Internet are included within the definition of "local" traffic. *See* Joint Comments at 21. But the precise meaning of, or even existence of, Section 51.701 is not the heart of the problem. The heart of the problem is statutory: whether the reciprocal compensation provisions of Sections 251(b)(5) and 252(d)(2) of the Act apply to calls that are plainly part of local exchange service under Section 3(47), but are nonetheless jurisdictionally interstate under Section 3(22). The Bureau should answer this question in the affirmative, for the reasons explained by the Joint Commenters and others.

IV. THERE IS NOTHING UNFAIR TO ILECS ABOUT REQUIRING THAT CALLS TO THE INTERNET BE SUBJECT TO COMPENSATION.

The Joint Commenters and others pointed out that the effect of denying reciprocal compensation for calls to the Internet would be to permit the ILECs to re-monopolize the market for providing dial-up connections to ISPs.[31] As the Joint Commenters and others observed, this result would be directly contrary to the policy of the United States to "promote the continued development of the Internet and other interactive computer services and other interactive media [and] preserve the vibrant and competitive free market that presently exists for the Internet and other interactive computer services."[32]

Ameritech recognizes that the terms on which ILECs and CLECs compete for the business of ISPs will be affected by whether calls to ISPs are subject to terminating compensation. Astonishingly, however, Ameritech argues that it would be unfair ***to the ILECs*** to require compensation for calls to ISPs who buy their local exchange service from CLECs. According to Ameritech, this is because the CLECs are misusing the terminating compensation system by negotiating for rates that turn the receipt of calls into a "cash cow," then using the cash to fund low local exchange rates for ISPs.[33]

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[31] *See* Joint Comments, Section II; WorldCom. Comments at 12-13; Hyperion Comments at n. 5; MCI Comments at 5-6; Brooks Fiber Comments at n.10; AOL Comments at 15-16; TCG Comments at 9-10; CIX Comments at 2; USX Comments at 9-10.

[32] 47 U.S.C. §§ 230(e)(1) and (e)(2). USTA's claim that the need for a uniform national policy to promote and enhance the development of the Internet requires recognition of the inherently federal, interstate character of traffic to and from the Internet is correct. *See* USTA Comments at 9-10. Its claim that treating circuit-switched calls to the Internet as "local" would contravene that policy by "ceding jurisdiction to the states," *id.*, is plainly wrong, for the reasons discussed in the Joint Comments, and in Section III of these Reply Comments.

[33] Ameritech Comments at 16-18.

Ameritech's argument is one version of a broader (and vaguer) claim made by many ILECs that it is unfair, unreasonable, or somehow inconsistent with the purpose or intended function of terminating compensation for CLECs to receive payments for calls to ISPs at all, much less to profit from terminating compensation payments for calls to such entities. If CLECs are actively seeking terminating compensation payments, the argument goes, something must be wrong.

The implication of this argument is that terminating compensation payments should be a wash, neither higher or lower than the actual cost the CLEC incurs in terminating calls. In that situation, the argument goes, then CLECs would have no economic motive to target customers with high incoming usage. It follows that if CLECs ***are*** targeting such customers, the terminating compensation payments they are actually receiving are too high, and the CLECs are receiving a windfall.[34]

This argument has a certain appeal from the perspective of traditional cost-based regulation. From that perspective, a terminating compensation rate, subject to at least some form of "regulation" under the terms of Section 252(d)(2), should accurately reflect the terminating LEC's costs. A cost-based rate, it would seem, would not create uneconomic incentives for the terminating LEC either to seek out or avoid customers who receive large numbers of incoming calls. CLEC behavior seeking out such customers, therefore, implies that there is something wrong either with the terminating compensation rate or with the application of the terminating compensation system to those customers.

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[34] Of course, as the Joint Commenters explained, when a CLEC takes a customer from an ILEC, the ILEC saves the costs of terminating that customer's calls, but continues to receive the revenue to cover those costs from its end users. As a result, the only windfall that is relevant to this issue is the windfall the ILECs will receive if they are not required to pay terminating compensation on calls to ISPs.

Despite its superficial appeal, this argument is in fact deeply flawed. First, it ignores the difference between economic cost, accounting cost, and cash flow. Second, it ignores the impact of economies of scale. Third, it ignores the existence of factors other than call termination costs and payments that affect a CLEC's choice of which customers to target. Fourth, it ignores the role that adversary negotiation plays in the rate-setting regime established by Sections 251 and 252. Finally, it ignores the fact that the ILECs themselves have created their real problem by voluntarily agreeing with state regulators to "lock in" uneconomic pricing arrangements for end users. The first three points are discussed in Section II.A. The last two are discussed in Section II.B.

A. CLECs Will Have Strong Incentives To Seek Customers With High Incoming Usage Levels Even If Call Termination Prices Are Set At A Perfectly Cost-Based Level.

The ILECs' key assumption is that the only reason that CLECs would actively target customers with high levels of incoming usage is that the terminating compensation payments the CLECs receive are too high, *i.e.*, above "cost" defined in some appropriate way. In fact, as described below, even assuming that terminating compensation rates are intended to be, and are, a perfect reflection of CLEC costs, there are several powerful business and economic forces that will drive CLECs to actively seek ISPs in particular and customers with high incoming usage in general.

1. A Cost-Based Terminating Compensation Rate Will Legitimately And Unavoidably Provide CLECs With A Source Of Much-Needed Cash.

As a new competitor in a capital-intensive business, a CLEC will almost always have more uses for cash than there is cash available. Most obviously, cash will be critically needed to expand and upgrade the CLEC's basic telecommunications infrastructure of switches, loops, and inter-switch facilities (including connections to the ILEC, to long distance carriers, and to other CLECs). In addition, cash will be needed to fund marketing and promotional efforts, which, on a per-customer basis, will almost certainly be higher for the CLEC than the ILEC. Finally, as with any business, the CLEC will need cash to meet current business obligations such as overheads (*e.g.*, rent, executive and administrative salaries, etc.) and interest on any debt capital the firm may have.

This point was succinctly made in a recent article regarding ISPs (as opposed to CLECs),[35] but the conclusion is identical:

> [Certain ISPs] are all still losing money from operations. On the positive side, this is not an unusual spot for new companies. Companies pass through very predictable life cycles: start-up, growth, and maturity. In the start-up phase they tend to burn a lot of cash. In fact, rapidly growing businesses are always cash-starved as new orders outstrip the cash coming in from last month's smaller order volume. They need new capital equipment to create more capacity to support higher sales. Nevertheless, while it may be nice to know that there is a business model to explain their situation — if managed well, they can outgrow the problem — ***they still need cash today.***

An economically "correct" cost-based call termination rate will almost by definition be a source of usable cash, even if the rate itself does not exceed economic "cost." This is due to the fact that a large fraction of the costs of running a telecommunications network are capital costs, primarily depreciation expense and equity return. Neither of these costs is a current cash expense. Consequently, an economically accurate cost-based termination rate — *i.e.*, one that includes capital costs — will almost certainly generate substantial cash over and above the amount needed to meet the immediate cash costs of performing the call termination function. CLECs will logically

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[35] P. Stapleton, "ISP$ Market Report: Some Options for the Cash-Short ISP," *Boardwatch Magazine* (July 1997) at 86 (emphasis added).

and legitimately assess the cash-generating qualities of different business strategies, and will have a strong incentive to select a strategy that generates the maximum amount of short-run cash to meet their network expansion and other business needs.

Targeting customers with high incoming call volumes is one such strategy. This fact, however, does not even remotely indicate a "flaw" or "problem" with either particular terminating compensation rates or the terminating compensation system in general. It simply reflects that new local exchange competitors have different short-term business needs than established, cash-rich, monopolistic ILECs.

In this regard, Ameritech has absolutely ***no*** basis for any claim that its reciprocal compensation payments to CLECs are higher, on a per-minute basis, than the CLECs' "cost" of terminating traffic.[36] As long as the terminating compensation payments are higher than the CLECs' short-run variable costs, those payments will be a source of short-run cash for CLECs.[37] Ameritech's real problem, therefore, is not that the CLECs are being over-compensated for terminating calls. Ameritech's real problem is that it does not like what the CLECs are doing with the payments they receive, which is offering lower prices to particularly desirable customers.

For CLECs to use the cash they receive for this purpose is not in any way unfair, and certainly does not imply that the payments the CLECs receive for

[36] There are any number of reasons to suspect that CLECs' per-minute costs will far exceed those of ILECs, including a much higher cost of capital (to reflect the risk of competing against an entrenched monopolist) and fewer economies of scale.

[37] For this reason, there is also no merit to Ameritech's claim that allowing calls to the Internet to be subject to reciprocal compensation "would prevent the Commission from adopting cost-based Internet access pricing, and introduce subsidies into such pricing that would distort the workings of a free marketplace." Ameritech Comments at 2. In capital-intensive industries, cost-based rates can, and do, generate cash that can be used for other purposes.